No. 93-448

In The

Supreme Court of the United States

October Term, 1993

ABRAMSON ENTERPRISES, INC.,

Petitioner,

v.

EDWARD E. THOMAS, Director,
Virgin Islands Bureau of Internal Revenue,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION

ROSALIE SIMMONDS-BALLENTINE
Attorney General

PAUL L. GIMENEZ
Solicitor General

JOSEPH M. ERWIN
Assistant Attorney General (Tax)
Department of Justice
Government of the Virgin Islands
48B-50C Kronprindsens Gade
GERS Building
Charlotte Amalie
St. Thomas, U.S.V.I. 00802
(809) 774-5666

NEIL D. KIMMELFIELD
(Counsel of Record)
BALL, JANIK & NOVACK
Suite 1100
101 S.W. Main Street
Portland, Oregon 97204
(503) 228-2525

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QUESTION PRESENTED

Whether the court of appeals below erred in its determination that the ten-percent surtax imposed by the Virgin Islands pursuant to 33 V.I. Code § 581 is not a deductible State and local income tax for purposes of section 164(a) of the Internal Revenue Code as such Code applies in the Virgin Islands by reason of chapter 44, § 1, of the Naval Service Appropriation Act of 1922.

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BRIEF IN OPPOSITION

Respondent opposes the Petition for a Writ of Certiorari. The Petition raises no issue worthy of review by this Court.

Respondent does not challenge Petitioner's assertions under the headings List of Parties, Opinions Below, Statement of Jurisdiction, and Statutes Involved. Respondent does challenge Petitioner's Questions Presented and portions of Petitioner's Statement of the Case. Therefore, Respondent has restated the Questions Presented and submits its own Statement of the Case.

STATEMENT OF THE CASE

Respondent generally agrees with the factual portion of Petitioner's Statement of the Case.[1] Respondent believes, however, that Petitioner has misstated the applicable law. Accordingly, this statement is provided.

The statute establishing the territorial income tax system in the Virgin Islands is § 1 of chapter 44 of the Naval Service Appropriation Act of 1922 (codified, as amended, at 48 U.S.C.A. § 1397), which states, in pertinent part:

> The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands. . . .[2]

In 1935, the Internal Revenue Service interpreted this provision as establishing what is known as the "mirror system" of taxation, under which the income tax law applicable in the Virgin Islands is a so-called "mirror image" of the Internal Revenue Code, *i.e.*, a code in which

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[1] The factual portion of Petitioner's Statement of the Case begins with the third full paragraph on page four of the Petition and ends with the carryover paragraph on page six of the Petition.

[2] The statutory provision codified at 48 U.S.C.A. § 1642, quoted in part by Petitioner (*see* Petition, at p. 2), requires Virgin Islands inhabitants to remit their *United States* income tax liabilities to the Virgin Islands Treasury, *see Danbury, Inc. v. Olive*, 820 F.2d 618 (3d Cir. 1987), *cert. denied*, 484 U.S. 964 (1987), and has no bearing on this case. Moreover, that provision was repealed by P.L. 99-514, § 1275(b), 100 Stat. 2598.

the Virgin Islands stands in the place of the United States for purposes of construing terms like "foreign", "domestic", "resident", "alien", "federal", and so on. The Internal Revenue Service announced its interpretation in I.T. 2946, XIV-2 C.B. 109, which stated in part:

> [T]he "United States" and the "Virgin Islands" are separate and distinct taxing jurisdictions although their income tax laws arise from an identical statute applicable to each. In construing the [income tax laws], it will, of course, be necessary in some sections of the law to substitute the words "Virgin Islands" for the words "United States," in order to give the law proper effect in those islands. From the viewpoint of the Virgin Islands citizens of the United States residing in the islands must be considered as resident aliens. . . .

This interpretation was acknowledged with approval by the Court of Appeals for the Third Circuit[3] in *Dudley v. Commissioner*, 258 F.2d 182, 185 (3d Cir. 1958), and has been consistently applied by the Third Circuit in subsequent cases. *See Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910 (1971), *Great Cruz Bay, Inc. v. Wheatley*, 495 F.2d 301 (3d Cir. 1974), *Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d 180 (3d Cir. 1977), *cert. denied*, 435 U.S. 980 (1978), *Danbury, Inc. v. Olive*, 820 F.2d 618 (3d Cir. 1987), *cert. denied*, 484 U.S. 964 (1987), and *Johnson v. Quinn*, 821 F.2d 212 (3d Cir. 1987).

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[3] The Third Circuit Court of Appeals has sole appellate jurisdiction over tax cases arising under the income tax laws in effect in the Virgin Islands. 48 U.S.C.A. §§ 1612, 1613, and 1613a.

Danbury, Inc. v. Olive, 820 F.2d 618, provides an excellent example of how the word-substitution scheme operates. In *Danbury*, the Third Circuit held that (i) for purposes of the Virgin Islands "mirror code," a Nevada corporation is a *foreign* corporation because it is not incorporated under the laws of the Virgin Islands, and (ii) under section 882(b) of the "mirror code," such a corporation is taxable only on its gross income from sources within the Virgin Islands and its gross income that is effectively connected with the conduct of a trade or business within the Virgin Islands. 820 F.2d at 622.[4]

Under the Third Circuit's mirror-system decisions, the word-substitution scheme is methodically applied "except where it is manifestly otherwise required." *Johnson v. Quinn*, 821 F.2d 212, 214. *Chicago Bridge and Iron v. Wheatley*, 430 F.2d 973, involved a situation where this approach permitted deviation from strict word substitution. In *Chicago Bridge & Iron*, the Third Circuit had to determine whether the mirror code in effect in 1965 entitled the taxpayer, a Delaware corporation deriving all of its income from a business in the Virgin Islands, to the deduction then allowed under section 922 of the Internal Revenue Code to a Western Hemisphere Trade Corporation ("WHTC"). Under section 921 of the Internal Revenue Code, a WHTC was a "domestic corporation" that did all of its business in the Americas and derived at least

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[4] *Danbury* also held that, since the taxpayer in that case was a Virgin Islands "inhabitant," it was obligated to pay its United States income tax liability on its worldwide income to the Virgin Islands treasury under 48 U.S.C.A. § 1642, a statutory provision not at issue in this case.

95 percent of its income from "sources without the United States." The Virgin Islands contended that the taxpayer was not a WHTC for mirror code purposes because, under the mirror code, the term "domestic" meant "incorporated in the Virgin Islands." The Third Circuit rejected this argument on the ground that, if strict word substitution were followed in identifying WHTCs under the mirror code, "every business enterprise operating solely on the mainland could qualify for the [WHTC] deduction merely by incorporating in the Virgin Islands," a result that was manifestly incompatible with "a deduction intended solely to benefit business activities outside of the United States." 430 F.2d at 973.

The instant case involves the deductibility, under mirror code section 164(a), of the ten-percent surtax imposed by the Virgin Islands in 1986, 1987, and 1988 (*see* 33 V.I.C. § 581(a)), pursuant to authority granted by Congress to the Virgin Islands Legislature in 1976. *See* P.L. 94-392, § 5, 90 Stat. 1195. Section 164(a) provides, in pertinent part:

> Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:
>
> * * *
>
> (3) State and local . . . income . . . taxes.

In the proceedings below, Petitioner took the position that the surtax imposed by the Virgin Islands is deductible under section 164(a), reasoning that the surtax is described by the phrase "State and local income taxes."

(Pet. 4.[5]) Respondent took the position that, *under the mirror code*, the surtax is a "federal income tax," which is not allowed as a deduction under section 164(a) and is explicitly disallowed as a deduction by section 275(a)(1). (*See* Resp. App. 1a.) The court of appeals below agreed with Respondent (Pet. App. 3), and this Petition for a Writ of Certiorari followed.

REASONS FOR DENYING THE WRIT

A. The Decision Below Raises No Issue Worthy of Review by This Court

This case involves nothing more than a simple application of the Virgin Islands' "mirror system" of taxation by the Court of Appeals for the Third Circuit, which, by act of Congress, has sole appellate jurisdiction over Virgin Islands tax cases. The court of appeals below examined the applicable statutes, reviewed the mirror system precedents, and, consistently with those precedents, concluded that the surtax imposed by the Virgin Islands is not a deductible "State and local income tax" within the meaning of mirror code section 164(a).

Since the mirror system precedents do not demand strict adherence to the substitution of "Virgin Islands" for "United States" in situations where it is "manifestly otherwise required," *Johnson v. Quinn*, 821 F.2d 212, 214, the

[5] "Pet." references are to the Petition for a Writ of Certiorari. "Pet. App." references are to the Appendix to the Petition. "Resp. App." references are to the Appendix to this Brief in Opposition.

court of appeals below had to make a *judgment* – that is, it had to decide whether it is *manifestly required* that the surtax be treated as a deductible State and local income tax. In reaching the judgment that such treatment is not manifestly required, the court of appeals considered and rejected Petitioner's arguments. In particular, the court of appeals considered Petitioner's argument that Congress intended the surtax to be deductible under the mirror code, and it found the argument wanting. (Pet. App. 13-14.)

In sum, the decision below involves an interpretation of statutes that are applicable only to Virgin Islands taxpayers, it does not conflict with any decision of this Court or of any other circuit, and it is consistent with prior Third Circuit decisions and longstanding administrative practice.

B. The Decision Below Does Not Raise the Questions Presented in the Petition

In an attempt to make the decision below appear to warrant this Court's review, Petitioner asserts that the court of appeals ignored certain decisions of this Court regarding statutory construction by (i) failing to consider the impact of later legislation (Pet. 7-8, 13, 15-16), (ii) substituting its own judgment for that of Congress (Pet. 18-19), and (iii) failing to consider all of the wording of the applicable statutes (Pet. 20-21). Petitioner's assertions mischaracterize the decision below.

1. The Court of Appeals Below Did Not Fail To Consider the Impact of Later Legislation

Petitioner asserts that, in determining whether the surtax imposed by the Virgin Islands is a "State and local income tax" for purposes of section 164(a) of the mirror code, the court of appeals below ignored the second sentence of section 1274(b) of the Tax Reform Act of 1986 (hereinafter "TRA 86"), Pub. L. No. 99-514, 100 Stat. 2085, 2597. (Pet. 7-8, 13, 15-16.) Section 1274(b) of TRA 86 states:

> (b) AUTHORITY TO IMPOSE NON-DISCRIMINATORY LOCAL INCOME TAXES.—Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. *Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies.*

(Emphasis added.)

In fact, the court of appeals expressly considered this "later" legislation[6] and concluded that there is no evidence that Congress intended the Virgin Islands surtax to be deductible from Virgin Islands taxable income. (Pet. App. 8-10, 13-14.)

Moreover, it is apparent merely from an informed inspection of the second sentence of TRA 86 § 1274(b)

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[6] The surtax in question was authorized in 1976 by P.L. 94-392, § 5, ten years prior to the enactment of TRA 86. (*See* Pet. 3.)

that the sentence is intended to address the treatment of locally imposed Virgin Islands income taxes *under the Internal Revenue Code, not under the mirror code.* Section 901 of the Internal Revenue Code permits United States taxpayers to claim a tax credit with respect to income taxes paid or accrued "to any foreign country *or possession* of the United States." Code section 901(b). Section 901 of the mirror code, on the other hand, permits Virgin Islands taxpayers to claim a tax credit with respect to income taxes paid or accrued to any foreign country *or to the United States.* I.T. 2946, XIV-2 C.B. 109, 110 (1935), *updated and restated,* Rev. Rul. 73-315, 1973-2 C.B. 225. Thus, the second sentence of TRA 86 § 1274(b), which denies the section 901 credit for certain taxes imposed by the Virgin Islands, clearly applies for purposes of the Internal Revenue Code only, and not the mirror code. In fact, the legislative history of TRA 86 expressly states: "The Virgin Islands is provided with the authority to enact nondiscriminatory local income taxes (which *for U.S. tax purposes* would be treated as State or local income taxes) in addition to those imposed under the mirror system." H. Rep. No. 426, 99th Cong., 2d Sess., 488-89, S. Rep. No. 313, 99th Cong., 2d Sess., 483 (emphasis added).

2. The Court of Appeals Below Did Not Substitute its own Judgment for That of Congress

Petitioner asserts: "By determining that the Virgin Islands should receive the full economic impact of the maximum Surtax rate, the Third Circuit Court of Appeals substituted its judgment for that of Congress and judicially legislated a result not intended by Congress." (Pet.

18.) This assertion is false. As Petitioner concedes, there is absolutely no evidence, outside the statute itself, of Congress's intent regarding the quantum of economic benefit to be derived by the Virgin Islands from a surtax. (Pet. 17.) Therefore, no determination by the court of appeals on that subject can properly be viewed as "contrary to the intent of Congress." (*See* Pet. 19.) In fact, the court of appeals simply performed the judicial function of interpreting the applicable statutes. The court observed that the 1976 Congressional enactment authorized the Virgin Islands to impose a surtax at a rate of up to ten percent, and it reasoned that interpreting section 164(a) of the mirror code so as to allow the surtax to be deducted "would not only defy rationality but would serve to frustrate Congress's stated intention of allowing the Virgin Islands to levy a full 10% surtax on income." (Pet. App. 12.) The court's reasonable inference conflicts with no decision of this Court.

3. The Court of Appeals Below Did Not Fail To Consider all of the Wording of the Applicable Statutes

Petitioner asserts that, by refusing to apply section 164 of the mirror code in the manner urged by Petitioner, the court of appeals "ignored" portions of the applicable statutes, in alleged violation of this Court's decisions. The only statutes referred to by Petitioner are 48 U.S.C.A. § 1397 and section 164 of the Internal Revenue Code. Both of those provisions were scrutinized and interpreted by the court of appeals below. Petitioner's assertion is erroneous.

CONCLUSION

The decision below has limited applicability, does not conflict with any precedent of this Court or, indeed, of any other court, is consistent with prior Third Circuit decisions and longstanding administrative practice, and does not raise any issue of sufficient importance to warrant this Court's attention. Thus, no basis exists for granting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit. Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

ROSALIE SIMMONDS-BALLENTINE
Attorney General

PAUL L. GIMENEZ
Solicitor General

JOSEPH M. ERWIN
Assistant Attorney General (Tax)
Department of Justice
Government of the Virgin Islands
48B-50C Kronprindsens Gade
GERS Building
Charlotte Amalie
St. Thomas, U.S.V.I. 00802
(809) 774-5666

NEIL D. KIMMELFIELD
(Counsel of Record)
BALL, JANIK & NOVACK
Suite 1100
101 S.W. Main Street
Portland, Oregon 97204
(503) 228-2525

APPENDIX

Internal Revenue Code section 275.

(a) GENERAL RULE. – No deduction shall be allowed for the following taxes:

(1) Federal income taxes. . . .